MARKET SEGMENT REPORT **HAMBURGER** 89

Restaurant Business

A BILL PUBLICATION

JANUARY 1, 1990

TURNAROUND CLOSE-UP:
PERKINS' GAMBIT PAYS OFF

INDEPENDENT ST★R:
CONTI SHINES AGAIN

MENU IDEAS:
PASTA'S EXOTIC TWIST

LATELINE:
DUNKIN' DONUTS
CLAIMED

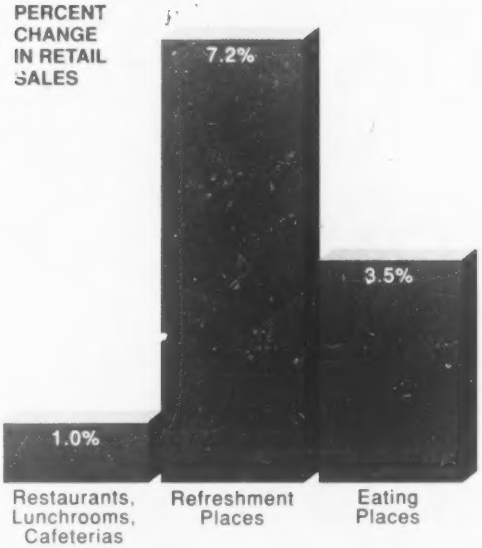
City Block's salad with fried wonton skins

CUTTING-EDGE CUISINE

THE HARD FACTS SHAPING OUR INDUSTRY

BUSINESS BAROMETER

PERCENT CHANGE IN RETAIL SALES



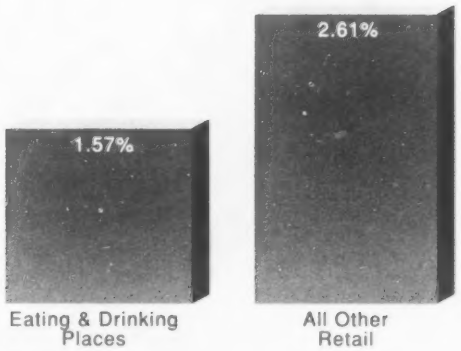
Refreshing Statistics

August 1989 retail sales for Eating Places increased to $13.8 billion from $13.3 billion for the year-earlier period—a 3.5% rise.

The growth was driven by Refreshment Places, which posted an increase of 7.2% (from $5.6 billion to $6 billion). These findings confirm those presented in the *RB* Growth Index issue (Sept. 20 1989)

SOURCE: U.S. Department of Labor, Bureau of Labor Statistics

CHANGE IN EMPLOYMENT EATING AND DRINKING PLACES vs. ALL OTHER RETAIL Sept '88-Sept. '89

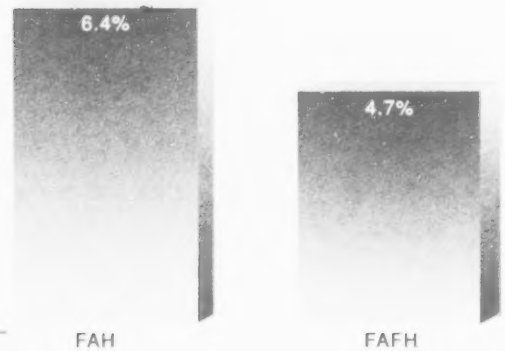


E&DP Employment Lags

According to data released by the Bureau of Labor Statistics, employment at Eating and Drinking Places increased 1.57% in Sept. 1989 over the year-earlier period. This compares with 2.61% for all other retail trade over the same period. The increase in all other retail trade is spurred by employment in food stores, which rose 5.4% during the same period.

SOURCE: U.S. Department of Labor, Bureau of Labor Statistics

PERCENT CHANGE IN CPI FOOD-AT-HOME, FOOD-AWAY-FROM-HOME July '88-July '89



Prices At Home and Away

The Consumer Price Index for Food Away From Home (FAFH) increased 4.7% in July 1989 over the year-earlier period. Food At Home increased 6.4%.

The FAFH price increases can be attributed in part to the inability of foodservice operations to pass price increases along to patrons, as well as the relatively small share of foodservice operators' cost directly representing food costs (30% to 40%, versus 75% to 85% for a retail food store).

SOURCE: U.S. Department of Commerce, Bureau of the Census

RESTAURANT BUSINESS

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COVER STORY

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Results of the *Restaurant Business*/Deustch, Shea & Evans exclusive **MANAGEMENT CAREER SURVEY** are available. For the full text of the 40-page report, contact: David Warhaftig, DS&E, 485 Fifth Ave., New York, NY 10017; (212) 687-8100.

The second annual **CENTER-OF-PLATE** Conference will be held in Chicago April 2 to 4. It is co-sponsored by the American Meat Institute and *Restaurant Business*. For information, contact Hilarie Hoting, AMI, PO Box 3556, Washington, DC 20007; 703-841-2400.

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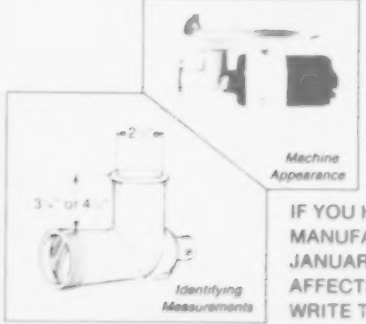

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HAMBURGER

MARKET SEGMENT REPORT

Market saturation has caused customer counts and segment sales to flatten.

By Jacque Kochak

WHILE THREE OF THE LARGEST chains in the hamburger segment suffer from flat or declining customer counts, several smaller regional chains with solidly defined niches are optimistic. Trouble at the top has put hamburger segment executives on alert, however. All are being affected as embattled McDonald's, Burger King, and Wendy's discount prices in an effort to build customer counts.

Discounting has escalated, and not everyone is elated about the trend.

"Short term, discounting can help sales, but it hurts margins," says Ted Murphy, vice president of marketing for regional hamburger chain Chattanooga, TN-based Krystal Co. "Long term, heavy discounting can erode a company's image."

And such discounting is very likely just a quick fix that doesn't address larger problems. "The chains with major problems seem to be trying to fix them with marketing, but the problems are with execution," says one observer.

MENU PROLIFERATION. Companies are also trying to bolster customer counts by continuing to add to their ever-broadening menus. Larger menus are clearly a more reasonable answer to the segment's woes than discounting.

One of the foremost practicioners of menu diversification is San Diego-based Jack In The Box. Since 1980, the 970-unit hamburger chain has introduced more than 30 new and innovative menu items. Recent additions include a double fudge cake, a grilled sourdough burger, a grilled chicken filet, and a scrambled egg pocket breakfast sandwich.

But menu diversification is not without its problems, says Jerry Singer, public relations director of Rocky Mount, NC-based Hardee's Food Systems. "Our broad menu is one of our strengths, but also one of our Achilles' heels," he says. "It is harder to train a worker to make 70 items than 10 items."

"I believe that our competitors are caught in a disastrous cycle of menu proliferation," says Steve Lynn, chief operating officer of Oklahoma City, OK-based Sonic Industries, which operates 1,000 drive-in restaurants throughout the Southwest. "They're increasing their break-even, their capital costs, and their labor costs," he adds.

DOUBLE DRIVE-THRUS. In recent years, a new kind of "burger baby" has grown up to address some of the problems plaguing the large burger chains. Double-drive-thru units offer a lower investment because buildings are much smaller. Labor costs are less because fewer employees are necessary. Lower costs mean lower prices, which make customers happy.

Entrepreneurs have sensed the potential. "Last year, we estimated there were some 300 companies with a double-drive-thru format," says Bobby Davenport Jr., president of Chattanooga, TN-based Central Park U.S.A.,

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Jack In The Box has a new burger served on a sourdough bun.

one of the first double-drive-thru chains. "Now I estimate there are 500."

Several large regional chains have also experimented with double-drive-thru units, but results have not always been thrilling.

"We have experimented with double-drive-thrus, but they are too narrow in focus," says Sonic's Steve Lynn. "The customer has been conditioned to a little more, and development costs are very high because the sites are so prime."

THE GIANT. McDonald's is a formidable force in the hamburger segment and in the industry as a whole. Everyone agrees that McDonald's is astutely managed, and the company is in the process of crowning its U.S. success with overseas success.

But on the home front, most observers agree, the markets are saturated. McDonald's, with its nearly 8,000 domestic units, is continuing to seek out unconventional sites such as hospitals and military bases.

In such a mature, saturated market there's little room for more growth without stealing market share. Since McDonald's already holds 18.7% of the total fast-food market anyway (and a much greater share of the hamburger market), where is the company going to steal from?

That's an interesting question, and the reason that competitors in other segments are keeping a watchful eye on McDonald's new product introductions.

When McDonald's tested a new pizza product recently, Pizza Hut promptly blitzed the test area with an advertising campaign knocking McDonald's product. McDonald's is also testing fried chicken, and Kentucky Fried Chicken is almost certainly watching. The burger chain also brought back a reformulated McRib sandwich as a promotional item.

Thanks to McDonald's massive size and very deep pockets, the company is able to reach out for market share in other ways, as well. In an effort to rebuild customer counts, McDonald's is apparently increasing discounting in its toughest markets.

BURGER KING. Beleaguered Burger King, acquired from Pillsbury in 1988 by the British company Grand Metropolitan P.L.C. after a ferocious battle, is taking aggressive measures to rebuild its own market share. Under Pillsbury, Burger King saw average unit volumes drop to below $1 million annually, and franchisees claimed that a rapacious parent company treated the subsidiary as a cash cow. The new management team under chief executive Barry Gibbon, a veteran of Grand Met's restaurant group overseas, is working especially hard at courting disenchanted franchisees.

The company's new image-oriented advertising campaign, "Sometimes You've Gotta Break the Rules," stresses employee helpfulness and courtesy. The campaign is a team effort from New York City-based agencies Saatchi & Saatchi Advertising and D'Arcy Masius Benton and Bowles, which have shared the chain's $215 million account since last spring.

Other moves aimed at courting customers include adding a toll-free number to handle customer questions 24 hours a day, a quality assurance program that includes mystery shoppers, and new employee incentive programs.

The company has expanded its line of double cheeseburgers to five: a bacon double cheeseburger; a bacon double cheeseburger deluxe; salsa burger; barbecue double cheeseburger; and regular double cheeseburger. Burger King is also testing fish as a finger food.

Whether such moves will turn Burger King around remains to be seen. Both analysts and franchisees are taking a wait-and-see attitude.

SUPER VALUE. Wendy's has also been tinkering with its menu. One offering is a "Super Value" line, emphasizing junior bacon cheeseburgers and garden salads at 99¢ each. The menu features smaller versions of several sandwiches, and larger versions of some menu items such as french fries.

The Dublin, OH-based chain's sales and profits remained flat during the third quarter, although a new advertising campaign featuring founder David Thomas has heightened customer awareness.

The company, with 3,754 units, also reports higher customer counts. Wendy's plans to resume expansion, with at least 100 new restaurants set to open systemwide in 1990. The company operates 3,200 units in 42 states and five foreign countries.

Hardee's Food Systems Inc., part of IMASCO USA, is the only top hamburger chain to continue to show sales increases. Historically, Hardee's has

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Regional chain Krystal operates 230 units in seven states.

grown 8% to 9% a year, says public relations director Jerry Singer, so current sales increases of 4% aren't wholly satisfying.

Singer says that during the third quarter, Hardee's average unit volumes reached $923,000, up from $808,000 just two years ago. Total systemwide sales reached $3.3 billion in 1988 and were expected to top $3.5 billion at the end of 1989.

Hardee's has developed a menu that is among the broadest in the hamburger segment. In addition to hamburgers and a full breakfast menu, Hardee's offers five chicken products: chicken stix, grilled chicken sandwich, chicken filet sandwich, chicken fiesta salad, and a chicken biscuit sandwich for breakfast. Most recent line extensions include the grilled chicken breast sandwich, which is nonbreaded, nonfried, and lower in fat and cholesterol than most sandwiches. Hardee's has also introduced Krispy Kurls, curly seasoned french fries.

Hardee's also recently introduced pancakes, and according to Singer, the company is still the industry leader in breakfast, with about 30% of sales deriving from the breakfast daypart.

Hardee's, like Burger King, is viewing better service as a key for battling in the crowded burger arena. During the past three years, the company has poured over $3 million into a training program called "Serve with Pride" that teaches and rewards employees for maintaining high standards in the areas of service, hospitality, cleanliness, and promptness.

Expansion is continuing at a steady pace, with about 250 restaurants opened in 1989. Fifty new franchisees also were signed. "One of our primary objectives is to get new blood in with single-unit operators," says Singer.

Last year, Hardee's drew massive attention with its clever "California Raisins" promotions. It has followed up with a "Ghostbusters" promotion, tied into the recent popular movie.

A SOUTHERN SUCCESS. Sonic Industries Inc. seems to be one of the definite success stories of the burger segment. At a time when other companies are battling flat customer counts and sales, Sonic boasts three straight years of double-digit sales increases on the unit level.

Sonic's expansion plans call for opening 60 new units in 1990, after opening 42 in 1989. Systemwide sales were expected to reach $410 million for calendar 1989. Average unit volume has reached $400,000, up 11% to 12% over last year. Volumes have soared from $265,000 when Steve Lynn joined the company as chief executive six years ago.

Sonic is celebrating its 30th anniversary, and the company has stayed close to the formula that has brought it success in former decades.

Sonic is the last major drive-in chain, with customers placing orders via intercom and waitresses delivering orders by tray to 24 stations. The menu hearkens back to another time.

"The country continues to go crazy over the '50s and nostalgia, so we use a hint of that in all our marketing," says Lynn. "Frankie Avalon is our spokesperson." But Sonic doesn't just rely on nostalgia to generate customer interest; this is the end of the '80s, and customers want speed and convenience.

"All our competitors have added drive-thrus, but their customers get a precooked product with no choice of condiments, and the average wait for

Some burger chains trade on fifties nostalgia.

the order is 13 minutes, because there is only one order station," says Lynn. "At Sonic we have 24 stations and fresh-cooked food arrives in less than four minutes. In our advertising, we're telling customers that they can come to Sonic to get their food faster."

The only new product introduced recently is a 44-oz. soft drink called "Route 44." Tested in August, the drink proved so popular that some units sell nine cases a week.

About 65% of Sonics are located in small Sunbelt towns, where real estate costs are cheap. And even though average unit volumes are small compared to a McDonald's or Burger King, so are capitalization costs. It costs an average of $350,000 to open a Sonic, compared to as much as $1.3 million to open an

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A frosty mug of root beer is A&W's point of menu differentiation.

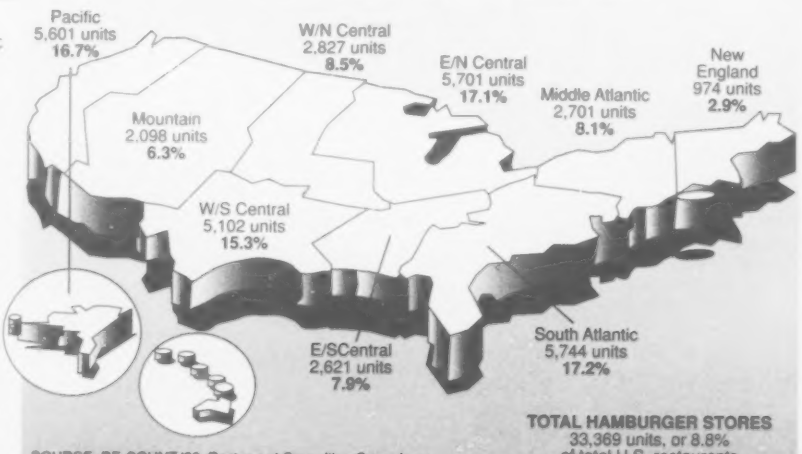
average McDonald's restaurant.

One thing that is changing is Sonic's buildings, which are also the same as 30 years ago. For that reason a prototype unit was developed in recent years. Some 90 of those units are now open, and the company has also put together a remodel package. Well over 500 units are now being remodeled or built from the ground up to conform to new guidelines.

COMPETITIVE POINTS. New executive vice president and chief operating officer of Livonia, MI-based A&W Restaurants Inc. is Vern Stewart, until recently executive vice president and COO of Sonic. He was part of a management-led LBO of Sonic in 1986. During the following three years, Sonic achieved growth in average unit sales of almost $100,000 a year. The company's growth was attributed to aggressive marketing.

WHERE THE BURGER BUYERS ARE

Distribution of Hamburger units by U.S. Census Regions



TOTAL HAMBURGER STORES
33,369 units, or 8.8% of total U.S. restaurants

SOURCE: RE-COUNT '89, Restaurant Consulting Group Inc.

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For information circle number 77

"When the Sonic turnaround started, we identified competitive points of difference and marketed those," says Stewart. "And Sonic's points of difference weren't as unique as A&W's."

"We have a very strong niche, and we want to play off that," he says. "We have a very strong signature product. We don't have to sell anybody on the idea of getting a frosty mug of root beer. We just have to let people know where to find us." A&W will also capitalize on the nostalgia called forth by references to the chain, which was the country's largest in the '50s and '60s, says Stewart.

"Our campaigns are targeted toward that period because so many people remember us," he adds. "But we have to be creative with our marketing, because we don't have the money to do massive advertising."

Stewart says that new marketing efforts will include promotions of root beer products. A&W will also offer promotions such as multiple meals in a package, and multiple meals with a large container of root beer. Discounting will increase, but only on peripheral products such as hot dogs.

A&W's goal for 1990 is to open 30 new stores, staying in regions where stores already exist. "A&W's experience of the last two years has shown me that the best ways for us to grow are through the conversion of existing restaurants to the A&W name, and through food court developments in shopping malls," says Stewart. In an interesting variation on franchising, A&W signed a deal with Carousel Foods in 1988 to convert 240 food court units to A&W, with the use of the A&W trademark.

Two hamburger companies that consider themselves virtually without competition in their own market areas are Chattanooga, TN-based Krystal Co. and Columbus, OH-based White Castle Systems.

Both serve burgers, but burgers with a difference. The burgers are very small, and a healthy teenager can gulp down many at a single sitting. And the burgers are steamed for a slightly different flavor and texture.

"We have a very unique niche," says Shirley Stapleton, White Castle's supervisor of public relations. "Our product is different. It's fast food, but if you want a White Castle, you have to come to us."

A total of 243 White Castles are now open, primarily in the Midwest, but spread as far as New York City and New Jersey. Expansion is going on at a rate of 15 stores a year. White Castle is private and does not franchise; Staple-

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ton points out that expansion is paid for from available funds and is slow, but very secure.

White Castle boasts average unit volumes of about $1.3 million, second only to McDonald's. Total 1989 sales were expected to reach $290 million, an astonishing figure considering that White Castle's modest little basic burger sells for only 35¢.

White Castle is staying away from the discounting frenzy. "We operate on a lower margin, and our product is modestly priced already," says Stapleton.

The company has seen slow, cautious change. In recent years the company has added a Castle Meal for kids and has developed a new building. The biggest change has been the introduction of frozen, microwaveable White Castle burgers in the supermarket. Burgers are now available in supermarkets in half of the country, says Stapleton, and in 1990 customers can get a White Castle at the grocery store in 85% of the country.

Ted Murphy, Krystal Co.'s vice president of marketing, echoes White Castle's Stapleton when he says, "We sell Krystals and cheese Krystals, not hamburgers. If they want a Krystal, they come to Krystal."

The company operates 230 restaurants in seven states, principally Tennessee, Georgia, Alabama, Mississippi, and Florida. Sales of the privately owned company were projected to reach $188 million in calendar 1989.

Murphy says that Krystal's sales are up anywhere from 5% to 15% for the last six to eight months. That percentage includes price increases; without increases, Murphy estimates that sales are still up slightly.

Like White Castle, Krystal is sticking to its core business, adding menu items cautiously and eschewing deep discounting.

On the new product front, the company is continuing its rollout of a small, hand-held breakfast sandwich called the Krystal Sunriser. On the promotion front, the company is offering insulated refillable squeeze bottles for soft drinks. It recently completed a successful Wizard of Oz glass promotion—units ran out of glasses by Wednesday every week, says Murphy.

Krystal has just begun franchising a new Krystal Kwik double-drive-thru unit. The scaled down units offer only the Krystal, the cheese Krystal, french fries, soft drinks, the Krystal Sunriser, coffee, and breakfast drinks. This is the first time the company has franchised in 60 years; if Krystal Kwik is successful, expansion will heat up, says Murphy.

Discounting may be causing long-term problems.

Krystal is also developing a prototype for full-size units that may be franchised into new territories.

DOUBLE DRIVE-THRUS. Double drive-thrus seem to have a solid future, because their format solves some of the major problems facing the burger giants today. Initial investment is modest because of their small size. For example, it costs between $150,000 and $250,000 to open a Central Park unit, with an annual volume of $500,000.

The royalty fee for a Central Park is also a low 3%. "On our menu, we don't charge 89¢ for a hamburger and then stick it to the customer on the cheese. We don't do that to our franchisees, either," says president Bobby Davenport Jr. Labor requirements are also very low.

Central Park, with $22 million in sales in 1988, now operates 44 units in the Southeast, and is opening units at a pace of two a month. That pace should accelerate to three or four a month in 1990. The company will continue to expand its base within an eight-hour driving radius of Tennessee, says Davenport. As franchising continues, company units are being sold off to owner/operators.

A TURNING POINT? Clearly, the days of easy expansion and sales growth in the hamburger segment are over. Companies are fighting for their businesses, and those with the most money or the clearest identity seem to have the edge.

"The segment is very competitive. We're all working to get the same customer," concludes White Castle's Stapleton. "We're looking at a possibility that some players won't even be here a year or two from now." ■

TEST KITCHEN

OPPOSITE: Pasta with an Oriental flavor: (clockwise from top left) chicken larmen; stir-fried vegetables arranged on top of crispy noodles; and savory fried dumplings served with a soy dipping sauce.

PASTA WITH PUTTANESCA SAUCE

(pictured on opening page)

4 tomatoes, peeled, seeded, chopped
½ cup sundried tomatoes, chopped
½ cup oil-cured black olives, pitted and coarsely chopped
3 cloves garlic, crushed
2 anchovies, mashed
½ cup olive oil
¼ cup parsley, chopped
¼ cup basil, julienne
Salt and pepper, to taste
1 lb. pasta, cooked

1. Combine fresh and sundried tomatoes, olives, garlic, anchovies, olive oil, parsley, basil, salt, and pepper. Let the mixture marinate for at least 2 hours, and preferably overnight.

2. Toss hot pasta with room temperature sauce. Serve immediately.
(Yield: 6 portions)

Garden, for example, now serve an average of 220 lb. of pasta every day.

PURCHASING OPTIONS. As pasta gains in popularity, purchasing options are keeping pace: While the majority of pasta (69%) is still sold in dried form, 35% is purchased fresh or made from scratch, and another 9% is frozen value-added product. Because fresh pasta contains a minimum of 20% moisture, it needs to be refrigerated, and therefore has traditionally been made from scratch or bought from local manufacturers who commanded a premium price due to smaller runs. The cost differential between dried and fresh, however, is shrinking with the rollout of nationally branded fresh products.

Pasta bought in any form serves as a versatile base for traditional or innovative fare. Units of Commack, NY-based Sbarro Inc. offer approximately five different pasta dishes every day—accounting for 50% of sales—including spaghetti, ziti, shells, lasagna, cannelloni, manicotti, and fettuccine. All pasta is precooked *al dente*, and then refrigerated until ordered. At service, the pasta is refreshed in a hot water bath in front of the customer to emphasize its prepared-to-order quality.

Larry Reyburn, vice president of marketing at Sbarro, points out that, "Different pastas can be blended with an assortment of foods and sauces." This lets Sbarro units customize their menus to suit regional tastes. "Certain markets are more accepting of different foods than others," Reyburn says. "By using different types of pasta and sauce combinations, we can efficiently offer more variety to those areas with people who are adventurous."

SAMPLER. The Old Spaghetti Factory, based in Indianapolis, has its own way of satisfying adventurous patrons. The Pot Pourri is a $4.35 spaghetti sampler that includes toppings of meat sauce, mushroom sauce, Mezithra cheese, and clam sauce. "Pasta is no longer limited to Italian food," says marketing director Bob Barr, "but you'll continue to see Italian restaurants become more popular."

At Dallas-based Sfuzzi, corporate executive chef Steven Singer calls his pasta preparations "traditional in ingredients, but not in execution." Dried pastas purchased from purveyors include rigatoni and linguini; flat pasta for lasagna, tagliatelli, fettuccine and cannelloni is made fresh on premise. One of Singer's more innovative dishes is an individual lasagna baked in a cake ring with three cheeses, grilled chicken, and spinach for $16.

ANYTHING GOES. Pasta's versatility and popularity has made it practical for even non-Italian menus to list a selection of pastas under a separate category. At the Courtyard Cafe in the Doral Court Hotel in New York City, the pasta section lists contemporary Cajun-inspired combinations such as linguine with seafood gumbo; and penne with okra, corn, and salami (see photo, page 117). According to resident manager Jay Stein, "The neutral taste and the texture of pasta gives Jean Paul Hascoat—our executive chef—the opportunity to try almost anything." Other pasta choices range from ziti topped with grilled chicken, cilantro, and hoisin sauce to fusilli with smoked chicken, mushrooms, and cream.

While Hascoat's dishes represent new pairings that are not necessarily Italian,

THE TOP TOPPINGS
Among those operators serving pasta as a main course, the popular pasta sauces are:
Marinara/Tomato 78%
Alfredo 39
White Clam 32
Garlic & Oil 30
Pesto 21
Red Clam 18
Other Sauce 18

SOURCE: RB Research